

*Docket NO. R-1417*

### **My Comment on the Dodd-Frank Act and Seller Financing**

The Dodd-Frank Act does not exempt property owners who wish to use seller financing (installment sale) even though no money is lent, there is no table funding, and under the Truth and Lending Act they are not considered creditors. The Dodd-Frank Act (ACT) does exempt property owners who offer seller financing from having to become Mortgage Loan Originators (MLO) provided they only sell 3 properties or less in a 12 month period and they follow the restrictions below. Yet, the Act subjects the property owner to the same liability as an MLO.

#### **Title XIV Section 1401 (2) (E)**

1. The seller did not construct the home to which the financing is being applied.
2. The loan is fully amortizing (no balloon mortgages allowed).
3. The seller determines in good faith and documents the buyer has a reasonable ability to repay the loan.
4. The loan has a fixed rate or is adjustable after 5 or more years, subject to reasonable annual and lifetime caps.
5. The loan meets other criteria set by the Federal Reserve Board.

Under this Act the only buyers who will be able to use seller financing are the buyers who can already qualify for conventional financing with perhaps the exception of how much of a down payment they need. Seller financing has always been the alternative to government regulated financing. It is a meeting of the minds between two private individuals who negotiate an arm's length contract to purchase property using an installment sale. The following is a breakdown of these restrictions. I listed them in order of greatest impact on property owners, buyers and the economy.

#### **3. The seller determines in good faith and documents the buyer has a reasonable ability to repay the loan**

The implication is that the seller must use the ability-to-repay underwriting requirements when offering seller financing consistent with the Dodd-Frank Act which amends the Truth in Lending Act. This new, proposed rule is 169 pages long. <http://www.gpo.gov/fdsys/pkg/FR-2011-05-11/html/2011-0766.htm>

The Consumer Financial Protection Bureau has spent a lot of energy developing a new, easy to read, two page mortgage disclosure form. It is unreasonable to expect sellers and buyers to fully understand and apply this 169 page rule. If buyer's and seller's negotiations deviate in the least the buyer has up to three years to rescind (Special Remedies) the sale and demand back all money paid to the seller, or anyone that the seller might have assigned rights and interest to, or any bank who takes the note as a collateral assignment.

This could be financially devastating to the seller. Let's not forget that today's buyer will be tomorrow's seller. These sellers are a diverse group. They come from all walks of life: low income, high

*Doclet NO. R-1417*

Income, non-English speaking, seniors, widows, minorities but this requirement places the same standards on individuals as banks and mortgage lenders, only with more risk – the banker is in the business of mortgage loan origination and factors that risk into his business plan, whereas the individual seller does not have capital reserves and doesn't do this as a business. Also, unlike a bank, they do not carry errors and omission insurance.

Unlike banks and mortgage lenders, both the buyer and seller are consumers. They should both be equally protected. The buyer is purchasing real property and the seller is investing in/creating a financial product where they receive their equity over time. The seller is relying on the buyer to make monthly payments and maintain and protect the property. Terms are not dictated to either party, but rather they are negotiated between the parties.

Requiring the buyer to turn over all their financial information to a stranger opens the door for identification theft and fraud. Furthermore, why should the buyer be required to divulge their income and assets to the very person with whom they are negotiating the terms of a sale? This is not required when there is a 3<sup>rd</sup> party lender.

This also creates the opportunity for predatory borrowing. This is where an unscrupulous buyer knowledgeable about the Dodd-Frank Act leads an uninformed seller (and this will be the majority of sellers) into negotiations not in compliance with the ability-to-repay requirements. (An example of that could be a balloon, an interest rate greater than 1.49% above a standard mortgage, or the seller did not know how to calculate the income to debt ratio correctly, or know what residual income means). That buyer lives in the property trying to resell it for a profit and if they are not successful within three years they rescind the sale (Special Remedies) and get all their money back.

The SAFE Act does not put in place the ability to repay requirements, or any other requirements, unless the individual habitually and repeatedly uses seller financing in a commercial context. So there is some consistency between the two laws the Dodd-Frank Act should not require sellers to use the standard of the ability-to-repay unless they use seller financing more than three times in a 12 month period. It is HUD's feeling that Congress never intended under the SAFE Act to restrict private property owners from using seller financing, unless they did it as a business.

## **2. The loan is fully amortizing (no balloon mortgages allowed).**

There is a good chance that a seller 55 years or older will die before receiving all their equity by not allowing them to negotiate a balloon payment. A lot of seniors have invested in real property with the intent of selling it using seller financing (an installment sale) in order to supplement their income in retirement, but also with the hope that they would not be stuck with a 30 year investment. The Dodd-Frank Act does the same thing insurance companies do who sell 30 year annuities to seniors. Our government has criticized this deplorable practice because seniors will die before they receive all their investment.

The restriction of no balloon doesn't affect just seniors, it has financial consequences for anyone using seller financing. Under the Dodd-Frank Act community banks are allowed to originate fully

*Docket no. R-1417*

amortizing loans with a five year balloon. The rationale is that they hold these loans in their own portfolios and the government recognizes their need to hedge against inflation and rising interest rates. Yet, the Act refuses to recognize that private property owners who have 100% retention (skin in the game) need the same protection. Obviously the Act does not feel that a five year balloon is predatory lending. This restriction should not be placed on seller financing until a property owner sells more than three properties in a 12 month period. If there has to be a restriction it should at the very least be the same allowance given to community banks of a balloon in 5 years.

**4. The loan has a fixed rate or is adjustable after 5 or more years, subject to reasonable annual and lifetime caps.**

This restriction is reasonable, but it will eliminate the ability for any buyer to wrap an existing obligation that has an adjustable rate even if they believe they can afford a rate increase. Again, for consistency with the SAFE Act there should not be any restrictions on any property owner that uses seller financing 3 or fewer times in a 12 month period. If the seller does not know about the ability-to-repay requirements and that they are not able to have a balloon, they certainly will not know that you have to have a fixed interest rate for the first five years.

**1. The seller did not construct the home to which the financing is being applied.**

There are a lot of small builders that have a spec house or two that they can't sell unless they offer great terms using seller financing. Otherwise they have to let these properties go back to the bank which does not help housing or the economy. There is also that group of out of work construction workers who built their own homes when times were good and now need to sell. This takes away their ability to use seller financing. Builders should not be subject to any restrictions unless they sell more than three properties in a 12 month period using seller financing. Builders are in the business of building; not of originating loans.

**Using a mortgage loan originator to facilitate a seller financed transaction creates additional risk and expense for both the buyer and the seller.**

It has been said that a seller financing the sale of his or her own property would completely avoid the issue of licensing by retaining the services of a licensed loan originator. If a mortgage loan originator (MLO) fails to properly follow the ability-to-repay guidelines the buyer still has three years in which to rescind the sale (Special Remedies) which leaves the seller at risk and will most likely bankrupt them. Furthermore, there is no provision in a MLO's errors and omission insurance that covers seller financing. None of the continuing education classes or the exams that an MLO must complete has a single chapter or question regarding seller financing.

Who is supposed to pay the MLO? MLOs can charge a flat fee or up to 3% of the transaction. The only advertisements I have seen so far advertise a flat nonrefundable fee of \$450. This fee has to be paid in advance, which makes sense because why would a MLO spend hours and hours on an installment sale transaction which might not close? If the buyer pays the fee, then this is a forced origination fee never before imposed on buyers seeking seller financing. Why should the buyer have to

*Docket No. R-1417*

pay money just to have an offer presented to the seller? A lot of buyers use seller financing because they are lower income and seller financing, up to now, has been an inexpensive way to purchase property. If the seller pays they will have to pay money for the simple act of the MLO forwarding them the installment sale offer. If the seller receives multiple offers this could easily run into thousands of dollars in MLO fees just to sell their property. A lot of sellers are also lower income individuals. The MLO will have to be a part of every offer and counteroffer because the sale and terms of an installment sale are one and the same and cannot be separated. For instance, the buyer might be willing to pay a higher interest rate if the seller is willing to come down on the price and down payment. A lot of seller financing takes place in rural areas that are underserved by mortgage lenders and banks. It is going to be very difficult to find a MLO in those areas who are also willing to take the risk facilitating a seller financed transaction. This has the potential of pushing seller financing underground – not a desired result.

The Dodd-Frank Act allows a property owner to use seller financing without having to become a mortgage loan originator as long as they don't use it more than three times in a 12 month period and comply with the above restrictions. In the SAFE Act there are no restrictions to the number of times seller financing can be used as long as you are not in the business of being a mortgage loan originator. The coauthor of the Dodd-Frank Act, Representative Barney Frank, sent a letter to HUD on July 22, 2010 urging them to place the maximum amount of seller transactions that an individual could do before becoming a MLO, or having other restrictions on them, at five in a 12 month period. I would propose that the Dodd-Frank Act adopt that same number and place no restrictions on seller financing until 5 is surpassed. The only restrictions that should apply to 5 or less are those restrictions that the States already impose either through state statute or case law.

Under The Act loan officers at community banks do not have to become a Mortgage Loan Originator if they originate 5 or less transactions in a 12 month period. The rationale is that this is burdensome, costly and there is not enough volume to create a systemic risk. Ma and Pa on Main Street should be granted those same allowances. The Act puts more restrictions and risk on Ma and Pa than it does on financial institutions.

In watching the debates in Congress last summer it was repeatedly said that the Wall Street Reform and Consumer Financial Protection Act would not negatively affect or over regulate Ma and Pa on Main Street. If this doesn't negatively affect and regulate seniors, minorities, and lower income individuals on Main Street I don't know what does. These restrictions will all but do away with seller financing which will have a negative impact on housing, existing property owners, those desiring to be property owners and the economy.

Submitted by Ric Thom, President Security Escrow Corporation